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November 9, 2017

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting[1,2]

on October 30 and 31, 2017

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy is expanding moderately. Going forward, it is likely to continue expanding on the back of highly accommodative financial conditions and the effects of the government's large-scale stimulus measures, with overseas economies continuing to grow at a moderate pace.

- With uncertainty regarding the outlook for the global economy abating, it is likely that business fixed investments that have been restrained for the past few years will be undertaken globally. The probability of the global economy continuing its firm growth through next year is rising.

- Although developments in overseas economies have been a risk factor, uncertainty has been abating gradually for some risks. Emerging economies have become firm, and the uncertainty has lessened as progress has been made in addressing such issues as those concerning the financial sector in Europe. Risks appear to be waning on the whole.

- Japan's economy is expanding moderately. Domestic demand such as private consumption and business fixed investment has been on an increasing trend. In fiscal 2017 and 2018, the economy is likely to continue growing at a pace above its potential. Thereafter, in fiscal 2019,

[1] English translation prepared by the Bank's staff based on the Japanese original.

[2] "Summary of Opinions at the Monetary Policy Meeting" is made through the following process: (1) each Policy Board member and government representative makes a summary of opinions that she/he presented at the Monetary Policy Meeting (MPM) under a certain word limit and submits this to the Governor of the Bank of Japan, who serves as the chairman of the MPM, and (2) the chairman edits those opinions as his responsibility.

the growth pace is expected to decelerate, due in part to the effects of the scheduled consumption tax hike.

- Japan's economy has been growing in a well-balanced manner, with both the supply and demand sides improving. Amid increases in demand both at home and abroad, the labor force participation rate and labor productivity have risen, partly reflecting efforts by firms and the government.

- The growth rate in labor productivity in Japan after the introduction of quantitative and qualitative monetary easing (QQE) is higher than that during the 10 years before its introduction and that in major economies.

- If firms' internal reserves accumulate excessively, the economy will have excess savings on the whole and the natural rate of interest could decline. It is important that the allocation of firms' funds to savings, investment, and employees is well balanced.

Prices

- Medium- to long-term inflation expectations are projected to rise as firms' stance gradually shifts toward raising wages and prices with an improvement in the output gap continuing. As a consequence, the year-on-year rate of change in the consumer price index (CPI) is likely to continue on an uptrend and increase toward 2 percent.

- The upward pressure on prices stemming from the rise in firms' costs has been increasing steadily, partly due to a continued clear uptrend in hourly scheduled cash earnings of part-time employees, reflecting the tightening of labor market conditions, and to a rise in input prices resulting from the past yen depreciation.

- In Japan, many firms have raised prices for the first time in more than two decades. In the context of changing the social norm, it is important for firms to accumulate experience from raising the prices of their products and services.

- Rises in the labor force participation rate and labor productivity are likely to exert downward pressure on prices in the short run. Such effects are expected to wane sooner or later, along with lesser slack in labor. In the long run, those rises are likely to raise the potential growth rate and contribute to pushing up prices, mainly through an abatement of people's concerns regarding the future.

- An environment has already been in place in which firms are able to dramatically raise productivity by proactively increasing investment in physical and human capital, mainly against the background of high corporate profits and labor shortage that reflect economic improvement, mainly resulting from the Bank's monetary easing measures. Achievement of the price stability target of 2 percent will come into sight as such improved productivity brings about a sustainable increase in real employee income, leading to an increasing trend in private consumption.

- It warrants attention that upward pressure on energy-related prices is likely to dissipate gradually, and downward pressure on telecommunication-related prices may be prolonged. Nonetheless, the momentum toward achieving the price stability target of 2 percent is maintained.

- The year-on-year rate of change in the CPI (all items less fresh food) is likely to increase moderately toward 2 percent. However, while the output gap has been positive, it seems to take some time to reach 2 percent as the inflation expectation formation is adaptive.

- There is still a long way to go before the price stability target is achieved in Japan because there remains an excess supply capacity in capital stock and the labor market.

II. Opinions on Monetary Policy

- The momentum toward achieving the price stability target of 2 percent is maintained. However, as price developments have continued to show weakness, it is important for the Bank to pursue the current powerful monetary easing with persistence.

- The Bank should continue with the current monetary policy with the aim of persistently encouraging the virtuous cycle to take hold and completely overcoming deflation.

- The framework of yield curve control incorporates a mechanism in which a rise in inflation expectations leads to a decline in real interest rates, thereby enhancing monetary easing effects. It is therefore possible to enhance momentum toward achieving 2 percent by maintaining the guideline for market operations.

- The current monetary policy is the most appropriate policy for providing an environment where firms can work on improving productivity continuously, as it has the least uncertainty in terms of policy effects. Should the Bank change the policy, it needs to be one that ensures achievement of the price stability target earlier and improvement in sustainability. It is appropriate to maintain the current policy unless the Bank has confidence in the effects of policy changes.

- The momentum toward achieving the price stability target of 2 percent is maintained, and thus it is important to adopt a wait-and-see stance for the time being until the policy effects materialize under the current framework. If the Bank takes an extreme measure only for the purpose of hastening to achieve the price stability target, side effects such as an accumulation of financial imbalances and an impaired functioning of financial intermediation could arise.

- In terms of an impact on the markets and financial institutions, as well as of the sustainability of the policy, additional easing measures will likely bring about side effects that outweigh positive effects.

- In addition to the liquidity in the Japanese government bond (JGB) market, domestic and foreign investors' attitude toward investment, as well as the securities portfolios held by financial institutions, warrant due attention.

- The policy effects and the possible side effects of the purchases of risky assets including exchange-traded funds (ETFs) should be examined from every angle.

- It is very important for both the government and the Bank to take a consistent stance toward achieving the price stability target of 2 percent.

- Some argue that, since the central banks in the United States and Europe are heading toward an exit, the Bank should follow suit. It is no wonder, however, that the Bank will be late in heading toward an exit, given that it started its monetary easing later than those countries.

- Some argue that the Bank would make losses at an exit from monetary easing, and this would cause a problematic situation. However, such argument is used by those who cannot see the wood for the trees. In the process of monetary easing, the ratio of fiscal deficit to nominal GDP will decrease as the Bank's payment to the government increases, reflecting a rise in the Bank's profits, and the government's tax revenue increases. In the long run, even after an exit, the Bank's profits are expected to increase along with the rise in interest rates.

- With a view to lowering the interest rates with longer maturities, the Bank should set 15-year JGB yields as an operating target of the long-term interest rate instead of 10-year JGB yields, and purchase JGBs so that 15-year JGB yields will remain at less than 0.2 percent. Through this additional easing measure, the Bank should ensure the path toward improving the GDP gap, increasing inflation expectations, and enhancing spillover effects to the CPI, thereby raising the probability of achieving the price stability target early.

- The Bank should introduce the commitment that it will take additional easing measures if there is a delay in the timing of achieving the price stability target due to domestic factors, with regard to the median of the Policy Board members' forecasts of the CPI in the *Outlook for Economic Activity and Prices* (Outlook Report).

III. Opinions from Government Representatives

Ministry of Finance

- The government will work to formulate a new economic policy package by the end of this year to achieve "Supply System Innovation" and "Human Resources Development."

- The government will not lower the flag of fiscal consolidation; with the aim of attaining a surplus in the primary balance, it will continue to undertake reforms from both the expenditure and revenue sides and draw up a concrete plan for achieving this.

- The government expects the Bank to continue to work toward achieving the price stability target under "QQE with Yield Curve Control" in light of developments in economic activity and prices, as well as financial conditions.

Cabinet Office

- The government will work to formulate a new economic policy package by the end of this year to specify the measures under the two pillars of "Human Resources Development" as well as "Supply System Innovation," and swiftly implement the measures, starting with those that are ready.

- The government expects that the Bank will work steadily toward achieving the price stability target of 2 percent in light of developments in economic activity and prices, as well as financial conditions.

- The government expects the Bank to continue to fully explain to the public the situation of its monetary policy management and the outlook for prices.